FIRETRAIL AUSTRALIAN SMALL COMPANIES FUND

MONTHLY REPORT | DECEMBER 2020

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	Fund incept
Fund	6.32%	23.85%	46.87%	35.02%
Benchmark	2.76%	13.83%	20.28%	2.47%
Excess Return	+3.56%	+10.02%	+26.58%	+32.55%

ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

AUSTRALIAN SMALL COMPANIES FUND

The Australian Small Companies Fund ("Fund") is a concentrated portfolio of our most compelling Australian Small Company ideas. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

INVESTMENT OBJECTIVE

The Fund aims to outperform the Small Ordinaries Accumulation Index over the medium to long term.

PORTFOLIO POSITIONING 31 DECEMBER 2020

Top 3 Overweight Holdings (Alphabetical)
Bega Cheese Ltd
Nuix Ltd
Serko Ltd

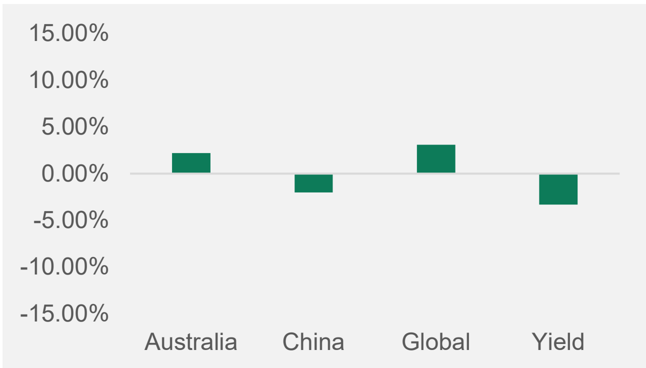
FUND DETAILS

Unit Prices	31 December 2020
Application price	$ 1.3540
Redemption Price	$ 1.3459
NAV Price	$ 1.3500
Fund Details	
APIR Code	WHT3093AU
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Inception date	20 February 2020
Number of Holdings	40
Fund size	$13mil
Management fee*	0.85% p.a.
Performance fee*	20% of outperformance

***Please read the Product Disclosure Statement for more details**

THEMATIC POSITIONING 31 DECEMBER 2020

Relative to the Benchmark



Past performance is not a reliable indicator of future performance.

1. Firetrail Australian Small Companies Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. 2. Fund inception is 20 February 2020.

PORTFOLIO COMMENTARY

The Fund returned 6.32% for the month ending 31 December 2020, outperforming the Small Ordinaries Accumulation Index by 3.56%.

CONTRIBUTORS TO RETURNS

Positive contributors to returns included holdings in biotechnology company Immutep, miner Independence Group and analytics company Nuix. Detractors included retailer Adore Beauty, gas producer Senex Energy and food manufacturer Bega Cheese.

SMALL COMPANY FOCUS

Immutep (IMM)

Immutep performed strongly over December (+54%) as the company released new data from its Phase IIb trial in metastatic breast cancer (MBC) for lead drug candidate Eftilagimod alpha (Efti). Immutep is a biotechnology company developing new immunotherapies (treatment that stimulates immune system response or remove its suppression) for cancer. In simple terms, with Efti the company is focused on developing a drug that activates the patient's immune system by binding onto Antigen Presenting Cells (APCs). APCs are responsible for activating T-cells that ultimately kill cancer cells - **the theory is that the drug thus hits the accelerator on the patient's immune system, boosting its natural fighting capabilities.**

Efti has significant commercial potential

Globally, there are 2 million new breast cancer cases each year with breast cancer accounting for 24% of all new cancer diagnoses among women. Whilst the number of pre-treatment options have increased, stand-alone chemotherapy continues to be widely used. There has been little innovation to date relating to drugs that improve outcomes for patients receiving chemotherapy.

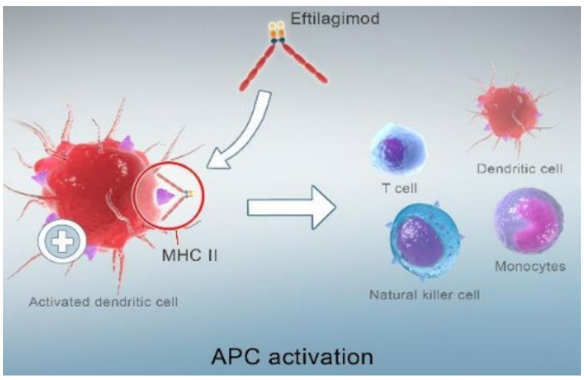
Why the trial results matter

In the trial reported during the month, patients either received Immutep's drug candidate (Efti) in combination with chemotherapy or a placebo with chemotherapy. The trial data demonstrated that patients under the age of 65 who received Efti saw a 50% improvement in overall survival rates relative to patients receiving the placebo. In other words, at 22 months half of the patient population treated with Efti were still alive. This point was reached 7 months earlier for the placebo cohort. In addition, for patients that had low white blood cell count (Fig 2), Efti improved overall survival by over 70% or 22 months relative to 13 months for the placebo arm. The data demonstrated that Efti is indeed "hitting the accelerator" on the immune system by recruiting more killer T-cells to the tumour site.

2021 will be an exciting year for Immutep

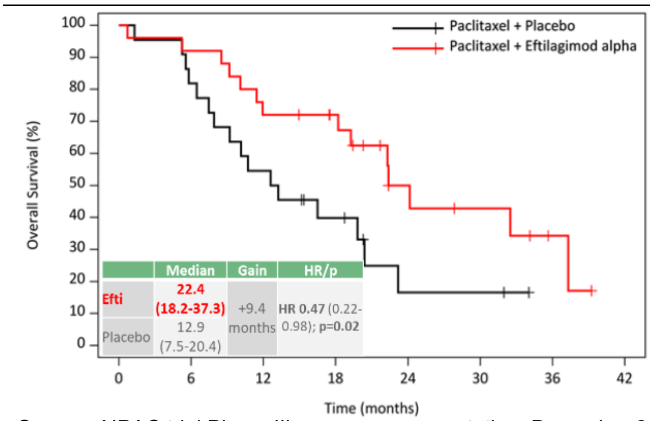
2021 will be a catalyst rich year for Immutep. Final overall survival data for the breast cancer trial is expected and there is the potential that the improvement in overall survival will be significant for the total patient population. In addition, we expect further updates from another ongoing trial for Efti in non-small cell lung cancer and head & neck cancer. These trials will be extended to larger patient populations following positive clinical results in 2020. Finally, we expect to hear updates on Immutep's out-licensed product from Novartis and GlaxoSmithKline. If Immutep's products continue to show improvements in patient survival across larger cohorts, we expect the company to progress to registrational trials across numerous cancer indications providing significant valuation upside from current levels.

Fig 1. Depiction of Efti's mechanism of action: binding to APCs thus activating the immune system to fight cancer



Source: Company presentation, December 2020

Fig 2. Overall survival data for patients with low white blood cell count receiving Efti vs Placebo



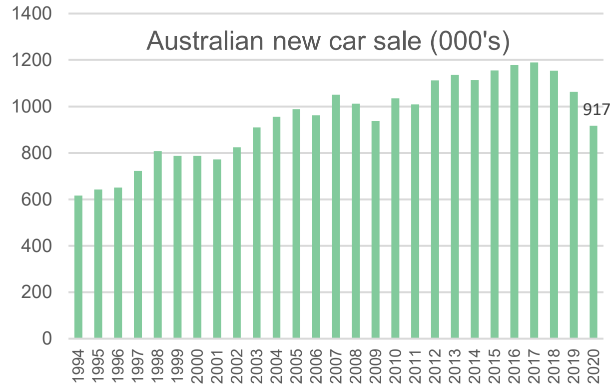
Source: AIPAC trial Phase IIb, company presentation, December 2020

SMALL THINGS THAT MATTER THIS MONTH…TURNING A CORNER ON NEW CAR SALES

A contentious topic. We spend a great deal of time analysing data and few charts have created more debate in the Firetrail office over the past several years than that of new car sales. On one side of the debate, we had the *'millennial'* view. A shift in consumer expenditure from tangible goods to experiences combined with a rise in the sharing economy will see a structural decline in new car sales and recent trends are an indication of this. On the other side, the Howard Marks inspired *'everything is cyclical'* view. That is, the data represents a slowdown caused by consumer confidence and a range of other factors, and it will bounce back.

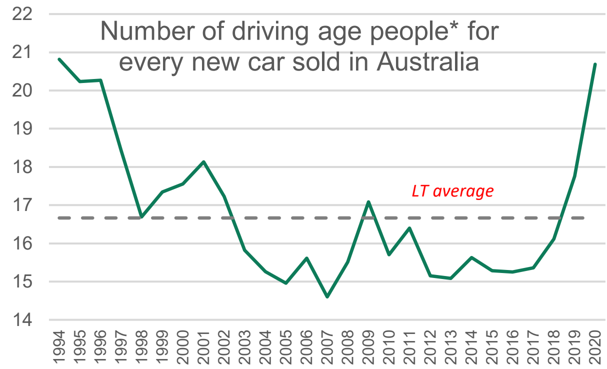
Few markets have been tougher than automotive sales. By any measure, the past few years have been tough ones for automotive dealers. While we eagerly anticipated a turnaround, the data just kept disappointing. Meeting after meeting with industry contacts and listed companies continued to suggest forward looking pressure on volumes *as well as declining margins*. Delving into some headline numbers - November new car sales of 81,220 vehicles represented the 31st consecutive month of YoY declines and 2020 sales of 917k units was a 17-year low!

Fig 3. In 2020 Australian new car sales reached a 17 year low following 31 months of YoY declines...



Source: ABS, VFACTS, Firetrail, December 2020

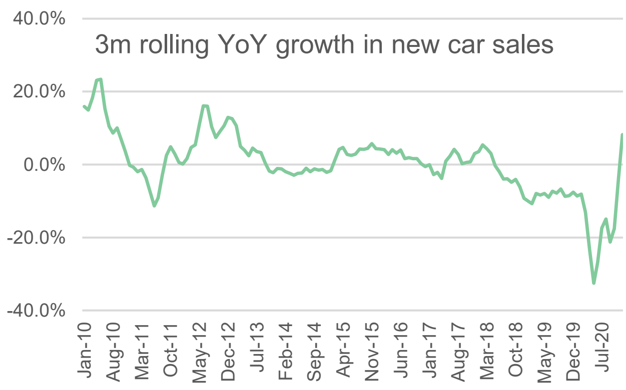
Fig 4. …historically, one new car has been sold for every 17 Australians of driving age - the ratio has expanded in recent years



*Defined as 18-80yo. Source: ABS, VFACTS, Firetrail, December 2020

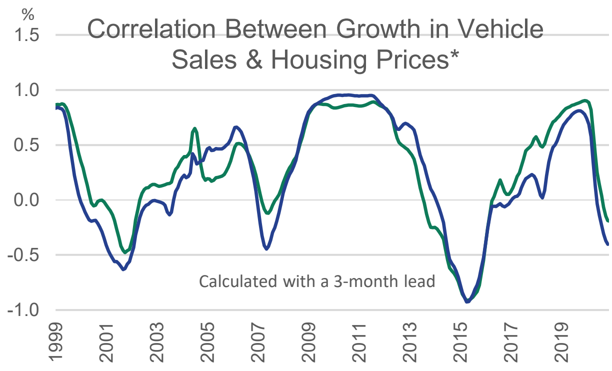
Things are looking up. November and December new car sales bucked the 3-year trend displaying 12.4% and 13.5% year-on-year (YoY) growth, respectively. Over the long term, pre-2020, new car sales growth of ~2.2% pa has run ahead of driving age population growth of ~1.4%. In determining our 3-year view, we believe *new car sales per driving age capita* is the most relevant metric. On this measure (Fig 4) it can be seen that the 2020 number of 1 new car sold for every ~21 people of driving age is the lowest since the data series began. If we assume a return to the long run average of 1 new car for every ~17 people of driving age in CY21 this would represent new car sales of ~1.14m units, ~25% growth on CY20!

Fig 5. November and December saw new car sales turn positive for the first time in ~3 years…



Source: VFACTS, Firetrail, December 2020

Fig 6. …a confluence of factors is responsible for the rebound however sales and house prices display a strong historical correlation



*Rolling 3yr window. Source: VFACTS, ABS, Macquarie, Firetrail, December 2020.

Why the turn? There is no clear answer and as to what is causing recent strength in new car sales and as with many macro data points, the water is muddied between correlation and causation. We hypothesise that the following 3 factors have had a significant impact:

1. **Increasing consumer confidence & wealth effect.** There is a strong correlation between consumer confidence and wealth measures such as house prices with new car sales. While this is not yet reflected in Figure 6, both measures have rebounded strongly in recent months.
2. **Holidaying at home.** Pre COVID, Australians spent some ~A$5bn per month offshore. Even if a small part of this budget is allocated toward upgrading or purchasing a vehicle this would see a substantial tailwind in new car volumes. Domestic travel also lends itself to motor vehicle purchases. As an example, Toyota Landcruiser and Nissan Patrol 4WD sales were up 128% YoY and 98% YoY respectively, in December.
3. **Aversion to public transport.** Due to health concerns many consumers are avoiding public transport and relying on private motor vehicles. In Sydney, the train and bus networks are running at 55% and 50% of capacity, respectively, while road traffic has returned to, and in some instances is exceeding, pre-COVID levels.

The reality on the ground is far better than the data. Recent conversations with industry participants highlight that underlying sales on the ground are even stronger than recent data points suggest. That is, after adjusting for new orders (headline data only tracks registrations) and ongoing weakness in Victoria. Many dealers expect inventory, not consumer demand, to be the limiting factor of new car sales in CY21. Consensus expectations of underlying revenue growth for the two listed dealers are in the order of ~5% which we view as conservative.

Margins and volumes move together. While a normalisation in revenue is positive for the sector, margins are even more so. Gross profit margins of automotive dealers are slim (~A$2k per vehicle) and have undergone substantial erosion over the past several years as volumes have declined and dealers were forced to compete on price to move stock. The sharp upswing in demand coupled with limited stock has seen gross profit margins expand by up to 50% for certain vehicles. For companies such as ASX listed Autosports Group we estimate that every 100bps increase in GP margin increases profit by ~40%!

When the ducks are quacking... Private equity has been active in the car dealership space over the past several years – interestingly, in late December, we saw East Coast car dealership business Peter Warren flag an intention to IPO in the first half of 2021. **The cynic in us says that 2021 will not be a year of depressed earnings for the sector.**

Our preferred exposure is Autosports group (ASG). ASG is an East-Coast-focused luxury and prestige car dealer and is our preferred exposure for the small company fund. Since IPO in 2016, ASG has faced challenging market conditions as highlighted above. During this time management have consistently outperformed the market by gaining market share and have executed on growth strategies to grow and diversify the business. We believe that the market is underestimating the underlying earnings potential of the business on a 3-year view as well as the leverage in short term earnings. From a valuation perspective, ASG is trading on just ~9x 12m forward earnings compared to peer A.P. Eagers on 21x and the Small Ordinaries Industrials Index on 23.4x.

MORE INFORMATION

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Existing client enquiries 1300 360 306

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Firetrail INVESTMENTS